Tolley®CPD

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Personal tax

Company cars - advisory fuel rates from 1 June 2017

HMRC has published revised advisory fuel rates for company cars, applying from 1 June 2017.

The rates are to be used only where employers either reimburse employees for business travel in their company cars, or require employees to repay the cost of fuel used for private travel.

Engine size	Petrol - per mile	LPG - per mile
1400cc or less	11 pence	7 pence
1401cc to 2000cc	14 pence	9 pence
Over 2000cc	21 pence	14 pence

Engine size	Diesel
1600cc or less	9 pence
1601cc to 2000cc	11 pence
Over 2000cc	13 pence

Hybrid cars are treated as either petrol or diesel cars for this purpose.

Reimburse employees for business travel in their company cars

If an employer pays a rate per mile for business travel no higher than the advisory fuel rates, for the particular engine size and fuel type, HMRC accept there is no taxable profit and no Class 1A National Insurance to pay.

An employer can use their own rates that better reflect their circumstances if, for example, their cars are more fuel efficient, or if the cost of business travel is higher than the guideline rates. If they pay rates that are higher than the advisory rates and cannot demonstrate the fuel cost per mile is higher, there is no fuel benefit charge if the mileage payments are solely for miles of business travel. Instead, they will have to treat any excess as taxable profit and as earnings for Class 1 National Insurance purposes.

Require employees to repay the cost of fuel used for private travel

If employers have correctly recorded all miles of private travel and used the correct rate (or anything higher) to work out the cost of fuel used for private travel that their employee must repay them, HMRC will accept there is no fuel benefit charge.

The advisory rates will not be binding where the employer can demonstrate that employees cover the full cost of private fuel by repaying at a lower rate per mile.

www.gov.uk/government/publications/advisory-fuel-rates

Updated list of approved professional bodies

HMRC has updated its 'List 3' - deduction for fees and subscriptions paid to approved professional organisations and learned societies under ITEPA 2003, s343) in June 2017.

Latest additions include:

- British Association of Gynaecological Pathologists, from 2017/18
- Faculty of Party Wall Surveyors, from 2016/1
- Institute of Safety in Technology and Research (ISTR), from 2016/17
- Special Libraries Association, from 2016/17

Trading income taxed as employment income

Summary – The Upper Tribunal found that, despite s15 ITTOIA 2005's deeming provision, the income of a professional diver was taxable as employment income.

Mr. Fowler, resident in South Africa, was a qualified diver. In 2011/2012 and 2012/2013, he carried out diving engagements in the UK Continental Shelf waters.

He is a resident of the Republic of South Africa for the purposes of the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains (the "Double Tax Treaty"). The Double Tax Treaty has been incorporated into English law by the Double Taxation Relief (Taxes on Income) (South Africa) Order 2002, S.I. 15 2002 No. 3138.

Both parties agreed that if Mr. Fowler was self-employed in the relevant tax years, then his diving income was not taxable as he has no permanent establishment within the UK.

- HMRC believed that Mr Fowler should be taxed on his diving activities as employment income (UK/South Africa double tax treaty article 14) rather than business profits (article 7).
- Mr Fowler argued that under s15 ITTOIA 2005, the performance of duties of employment consisting in seabed diving activities should be treated as the carrying on of a trade. Thus he was self-employed and so exempt. Alternatively he argued that the effect of this section was to bring his income within double tax treaty article 7, even if that income was otherwise from employment within article 14.

Decision

The Upper Tribunal held that the key term within Article 14 was the term "employment" (i.e. the status) rather than the "salaries, wages and other similar remuneration derived...in respect of" it (i.e. the fruits of that status).

As a result the tribunal resorted to English law only to understand the term “an employment”, so they only considered S 4(1) of ITEPA 2003. S15 ITTOIA was not relevant to the definition of “employment” because it relatesto the definition of “employment income”, which is irrelevant for the purpose of construing the term “an employment” within Article 14.

Mr Fowler’s income was taxable as employment income.

HMRC v Martin Frederick Fowler [2017] UKUT 0219 (TCC)

Off-payroll rules and healthcare workers (Lecture P1021 – 11.38 minutes)

As we know, from 6 April 2017 public authorities now have the responsibility for deciding whether IR35 applies to off-payroll workers. Where relevant, the public body is responsible for deducting income tax and NIC from these workers’ as if they were employed.

So since 6 April 2017, NHS Trusts and Health Boards have had new responsibilities to inform locum agencies and candidates if the role required falls within or outside IR35 legislation.

This will not affect staff who are already on the payroll and tax and NIC is being deducted. However the NHS uses a large number of locums and agency staff to ensure that they can deliver their service to the public. These new rules may affect workers who are being paid:

- through their own personal service company (PSC);
- through an intermediary for an umbrella company;
- as self- employed.

NHS viewpoint

NHS Improvement is responsible for overseeing foundation trusts and NHS trusts. In a letter sent to NHS providers in February, seen by The Register, the NHS had said that:

> "HMRC will treat all public sector 'self-employed' contractors using a PSC as falling under IR35 and therefore treated for tax purposes as an employee. As a result of these new rules, we anticipate that providers will need to ensure all locum, agency and bank staff are subject to PAYE and on payroll from 1 April 2017."

So the NHS believed that by default, everyone should have tax and NIC deducted by them from the start of this tax year.

BMA viewpoint

The BMA’s website disagrees with this view. The criteria for assessing whether an individual operating through an intermediary falls foul of IR35 has not changed; where a worker has legitimately been working outside of IR35 through their limited company, then nothing should change. So not everyone is necessarily affected.

The legislation specifies that the new rules apply to ‘public authorities’ which are defined by the Freedom of Information Act 2000.

In the NHS, those authorities are:

- NHS England
- CCGs
- Strategic health authorities
- Local health boards
- NHS trusts and foundation trusts
- Community health councils
- GMS practices
- PMS practices

This means that APMS providers are unaffected, as well as private commercial providers who are contracted to provide NHS services such as some out-of-hours services, walk-in clinics and urgent care centres.

U-turn by the NHS

As reported in The Register (31 May 2017), earlier this year Contractor UK reported that 30 contractors abandoned an overrun £16.5m health service IT project after an NHS trust said it would declare them all inside IR35 from 6 April.

Dave Chaplin, chief exec of ContractorCalculator, said that many public sector firms have discovered that blanket rules have had a hugely negative impact and highly skilled contractors have been leaving the public sector in droves.

As a result, the NHS has changed its mind and now says that it plans to consider individuals on a case-by-case basis rather than the previously announced default position of deducting income tax and NIC from all workers.

The big question is, given the number of people employed by the NHS, does the NHS have the time to perform this check for each and every person? Although the final decision will rest with the public body, workers who believe that they fall outside of the net, may well need to be in a position to argue their case.

Off-payroll rules and BBC freelancer and contractors (Lecture P1021 – 11.38 minutes)

Under the new rules, from 6 April 2017 the BBC are responsible for deciding whether IR35 applies to their off-payroll freelancers and contractors. All contractors and freelancers engaged through a Personal Service company as well as the self-employed will have their tax status assessed before being engaged to work. Included within their FAQs for BBC freelancers and contractors dated 27 March 2017, the BBC confirm that such workers will be assessed to decide whether they should be on or off payroll.

Modus operandi

Workers who satisfy the TV/ Radio Modus Operandi will be paid gross. These Modus Operandi are HMRC documents that list job roles in Television and Radio and indicate the conditions that need to be satisfied for gross payment to apply. They also highlight roles where gross payment status is deemed unlikely.

In principle, to qualify for gross payment, the period of engagement must not exceed 9 months on any single specific programme or serial or for a one–off production such as a film, or single drama or documentary.

If the individual is re-engaged after having completed an initial 9-month or one off engagement, the re-engagement has to be on a PAYE basis unless one of the following applies:

- The individual has had a break where it can be shown that they were either seeking work elsewhere or they were actually working elsewhere;
- They are being re-engaged on a second series of the same programme;
- The re-engagement is for 9 months or less and it can be demonstrated that the re-engagement was completely separately negotiated from the first.

For certain jobs the freelancer must to be working for the majority of the time away from BBC premises or BBC hired studios. Additionally, for some roles, the freelancer needs to supply the equipment needed to complete the job for the BBC. HMRC are interested to see a real investment by the freelancer including buying, insuring, maintaining their equipment. The equipment requirement is detailed in the table of roles.

Special letters

If freelancers can provide enough evidence to HMRC that they are running their own freelance business, HMRC will issue a Lorimer letter, also known as LP10, special or exemption letter. Such a letter allows freelancers to be paid gross even where the role is not on the Modus Operandi or where the terms of the modus are not being met.

These letters are so called following the 1993 Lorimer v Hall case where Mr Lorimer was a TV technician working for up to 20 production companies at any time. Despite not using his own equipment, Mr Lorimer won his case and was treated as self-employed. Following this case, self-employed freelancers can request a review of their personal tax status from HMRC.

Where freelancers do not meet the conditions of the Modus, the BBC are suggesting that freelancers apply for an LP10 letter from HMRC. However freelancers are reporting that these letters are becoming increasingly hard to obtain, possibly due to the introduction of HMRC Employment status tool.

http://downloads.bbc.co.uk/partnersandsuppliers/freelancers/MOclarification.pdf

Software developers struggling with personal allowance setoff

Last month Robert Jamieson provided us with some useful examples of how the personal allowance setoff is causing problems when submitting 2016/17 tax returns online. He highlighted two groups of taxpayer where HMRC’s online filing parameters, which software providers must follow, are such that individuals falling into either of the categories highlighted will be overcharged by up to £1,000 if their returns are filed online. He said that the only solution for 2016/17 was to file paper rather than online returns.

It seems that HMRC are not the only ones having problems. With queries on CPD courses from tax practitioners and on exam training courses from tax trainees, it seems that software providers have not quite got their heads around how the personal allowance setoff is working. Indeed one example reported to us, has seen a tax practitioner query the outcome with their software provider, who has since updated their software to correct the problem. It is understood that the returns will be rejected by HMRC's software due to incorrect parameters and so the return will need to be submitted in paper format.

The scenario concerned was not dissimilar to the example.

Example

Mr X has the following income in 2016/17:

	£
Employment income	36,000
UK interest	2,500
UK dividends	8,000
	46,500

Remember to be entitled to the higher £1,000 personal savings allowance the taxpayer's adjusted net income must fall into the basic rate tax band (£32,000 for 2016/17). The taxpayer's adjusted net income is £46,500 and so is only entitled to £500.

Adopting the "historical" order of set-off of personal allowances against non-savings income, savings income and finally dividends, the tax liability would be:

	Non-Savings	Interest	Dividends
	£	£	£
Employment income	36,000		
UK interest		2,500	
UK dividends			8,000
Personal allowance	(11,000)		
	25,000	2,500	8,000
Tax:			
25,000 @ 20%	5,000		
500 @ 0%		0	
2,000 @ 20% (Income too high for 0% rate band)		400	
4,500 @ 0% (Covered by dividend allowance)			0
32,000 (Basic rate band)			
500 @ 0% (Dividends covered by rest of allowance)			0
3,000 @ 32.5%			975
Tax liability totaling £6,375	5,000	400	975

Using this approach the savings and dividend allowances are used but the taxpayer payer ends up paying some tax at 32.5% on their dividends.

From 2016/17

Remember that S25(2) ITA 2007 states that reliefs and allowances should be deducted 'in the way which will result in the greatest reduction in the taxpayer's liability to income tax'

Where possible, taxpayers should look to allocate the personal allowance so as to avoid wasting the savings and dividend nil-rate band and allowances but also look to ensure that income that remains taxable is taxable at the lowest rates possible. We should look to push these nil bands into the space which would otherwise have been taken up by income taxable at 40% or 32.5% and so push "taxable" income down into the basic rate band.

Ideally our taxpayer would look to avoid paying higher rate tax. This could be achieved by allocating £3,000 of the personal allowance against dividend income with the balance of £8,000 against non-savings income.

	Non-Savings	Interest	Dividends
	£	£	£
Employment income	36,000		
UK interest		2,500	
UK dividends			8,000
Personal allowance	(8,000)	____	(3,000)
	28,000	2,500	5,000
Tax:			
28,000 @ 20%	5,600		
500 @ 0%		0	
2,000 @ 20%		400	
5,000 @ 0%			0
Tax liability £6,000	5,600	400	0

The tax saved is £375 (6,375 – 6,000) which is reconciled as:

		£
Tax saved on dividends	£3,000 @ 32.5%	975
Less extra tax on savings income	£3,000 @ 20%	(600)
Net saving		375

Incidentally, the same answer would be produced by setting £6,000 of the personal allowance against non-savings income, £2,000 against the interest and £3,000 against dividends.

With both HMRC and the software providers struggling, it seems that for now we will need to check the personal allowance setoffs that our software is making to ensure that our clients pay as little tax as possible. For this year at least there will be a number of scenarios where our clients will need to file paper returns. Let us hope that HMRC will take on extra staff to deal with the manual processing that will be required.

Savings allowance and savings nil rate (Lecture P1022 – 12.27 minutes)

FA 2016 Section 4 amends ITA 2007 to make provision for the new tax rules on savings which apply to interest credit on or after 6 April 2016. Note that the existing definition of savings income in ITA 2007 **excludes** dividends.

There remains a starting rate for savings, which is a band of £5,000 to which the starting rate for savings applies if the taxable non savings income does not exceed this amount. The current starting rate for savings is 0%.

The new personal savings allowance (PSA) applies irrespective of the amount of non-savings income, but is available dependent upon the "Step 3 income" in ITA 2007, s23 (taxable income net of personal allowances).

Where this amount is no more than the basic rate limit, and includes some savings income, the first £1,000 is taxed at the savings nil rate, the balance of the savings income being taxed at the normal savings rates (which are presently the main rates).

Where this amount exceeds the basic rate limit but is no more than the additional rate limit, and includes savings income, the first £500 is liable at the savings nil rate, the balance taxable at normal rates.

Planning point – Interaction with the £5,000 0% starting rate

A 0% starting rate applies for interest income, but only where taxable non-savings income is less than £5,000. Non-savings income includes employment income, trading income, property income and trust income.

Dividends are not treated as non-savings income and will not affect the availability of the £5,000 0% starting rate.

Where taxable non-savings income is less than £5,000 and the taxpayer has some interest:

1. The taxable non-savings income (if any) is taxed at 20%; and

2. The difference between the taxable non-savings income and £5,000 is taxed at 0%.

Example (assuming a personal allowance of £11,500)

Salary of £8,150, directors loan interest and dividends on top

….£5,000 of 0% starting rate available (plus the PSA)

Salary of £11,500, directors loan interest and dividends on top

….£5,000 of 0% starting rate available (plus the PSA)

Salary of £15,000, directors loan interest and dividends on top

….£1,000 of 0% starting rate available (plus the PSA)

Salary of £20,000, directors loan interest and dividends on top

….0% starting rate not available (but the PSA should be)

Note that where interest income falls in the 0% starting rate band there is no tax liability on the income. However, the income must still be included as taxable interest income in the income tax computation.

An interest rate in the region of 8% would be reasonable on a director's loan so £6,000 loan interest could be paid on loan balances as low as £75,000. HMRC are currently accepting directors loan interest rates of 6% to 8% depending on the circumstances of the company.

Lending to fund purchase of student accommodation

Consider a client who wants to utilise the equity in his home to fund the purchase of student accommodation. He could borrow on his home at around 1.8% fixed for five years on an interest only deal with Santander. He then lends the money to a newly formed property company at 6% which could access the £5,000 starting rate and personal savings allowance.

Illustration

Hilary and Ben both draw salaries of £11,500 and dividends of £60,000 from their trading company. Their home is currently worth £600,000 and their mortgage is £95,000. The mortgage has three years to run and monthly repayments are in the region of £2,750.

They would like to use their equity to invest in student accommodation where it is feasible to get a pre finance yield of 10% in certain university towns.

They secure an interest only re-mortgage of £275,000 at a five year fixed interest rate of 1.8%. After settling the existing mortgage they lend their newly formed property company £180,000 at 6%. The interest amounts to £5,500 each and is tax free in Hilary and Ben's hands.

The monthly mortgage repayments are set at £412.50 for five years. The monthly savings could be put into an ISA that should build up to a reasonable sum after 5 years i.e. £120,000 with no growth.

The company buys a six-bed student property in a university town for £180,000 including all costs. The property is fully managed and secures a net yield of £18,000 before finance.

After deducting the interest paid to Hilary and Ben of £11,000, the property has a pre-tax surplus of £7,000. After corporation tax this nets down to an annual surplus of £5,670 in the company.

In Hilary and Ben's hands they receive tax free interest of £11,000 from which they can pay the interest on their home mortgage. If we just consider the student related element of £180,000 this would be £3,240. This creates personal surplus of £7,760 (£11,000 - £3,240). The original mortgage element is ignored as this was going to be payable anyway.

So the post-tax returns on the student property are £13,320 (£5,670 + £7,760) which equates to a healthy 7.4%.

After five years they could decide whether to renew their personal mortgage or indeed repay it – pension lump sum, ISAs etc. The post tax yields will then increase to 9.25% - a healthy yield when heading for retirement.

Cleansing of mixed funds (Lecture P1024 – 11.55 minutes)

By virtue of Para 43 Sch 13 FB 2017, all non-UK domiciliaries who have claimed the remittance basis will, for a period of two years starting on 6 April 2017, be able to rearrange their bank accounts and separate the different component parts into:

- clean capital;
- foreign income; and
- foreign gains.

They can then make a tax-free remittance to the UK from their clean capital first. The existing mixed fund rules in S809R(4) ITA 2007 (which deem transfers from a mixed fund to be made in a certain order, depending on whether they are offshore transfers or remittances to the UK) are to be overridden on a temporary basis.

The key requirements for this relaxation are that:

- the transfer is a transfer of money made at any time during 2017/18 or 2018/19;
- the transfer is made from an account which is a mixed fund (as defined in S809Q(6) ITA 2007);
- the transfer is made into a different receiving account;
- the transfer is nominated as a transfer for the purposes of these rules by the individual involved;
- at the time when the transfer is made, no other transfer had been so nominated from that mixed fund into the receiving account; and
- the transfer is made by a 'qualifying individual', ie. an individual who has been taxed on the remittance basis in any tax year prior to 2017/18 and who is not an FDR.

Note that this relief does not apply to non-monetary assets such as a painting. Non-monetary assets do not qualify for cleansing. However, there is nothing to stop the individual from selling the painting during the two-year transitional window and separating out the sale proceeds in exactly the same way as he would do for other money.

Illustration

Maurice, a wealthy non-UK domiciliary who is now classified as a 'long-term resident', holds a substantial portfolio of foreign shares currently worth £2,000,000.

This has been built up as follows:

- £1,000,000 of clean capital which he originally invested;
- £500,000 of foreign income and gains which he subsequently added to the portfolio (eg. because shares were sold and the gains reinvested and because dividends were reinvested);
- £100,000 which he inherited in 2016 (ie. clean capital) and added to the portfolio; and
- £400,000 which represents his unrealised share gains.

If Maurice sells his share portfolio for £2,000,000 in 2017/18, any post-5 April 2017 element of the £400,000 gain will be taxed on him on an arising basis. But Maurice can then segregate the £400,000 realised on the sale, along with a further £1,100,000, and place the sum in a separate account. This will be treated as clean capital. It can be reinvested in anything which Maurice fancies (including UK shares) – any future income and gains will be taxed on Maurice on an arising basis.

The remaining £500,000 (representing the foreign income and gains) should be moved to a separate account and should not be remitted. If and when it is reinvested, this should not be in UK shares, as this would constitute a remittance.

Contributed by Robert Jamieson

Gift of shares to charity

Summary – The value of shares was based on what the hypothetical prudent purchaser would pay in the open market based on information available to them.

In 2004-05 qualifying investments were eligible for income tax relief when gifted to a charity under S 587B ICTA1988. Relief was given by reference to the market value. Qualifying investments included shares quoted on the Alternative Investment Market (AIM).

On 28 July 2004, Frenkel Topping Group Plc was the subject of a placing of shares and admission to the AIM.

Jonathan Netley was one of a number of shareholders who held shares in Frenkel Topping Group Plc and on the same date he gifted shares to St Ann's Hospice, a registered charity. He claimed that the share value on that date was 48p, the price at which shares were traded on AIM. He claimed relief on this gift in his 2004-05 return using this valuation. The amount of tax relief generated by Mr Netley's gift of shares was greater than the £10,000 cash he had invested to subscribe for the shares in or about June 2004.

More than half of the other shareholders in Frenkel Topping Group Plc gifted shares to various charities on the same date and more shareholders gifted shares to charity later in the 2004-05 tax year.

This case was a lead case looking to determine:

> "What was the market value of the shares in Frenkel Topping Group Plc which the Lead Appellant disposed of by way of gift to charity on 28 July 2004 as at that date for the purposes of section 587B ICTA 1988 (and on what basis and principles should the market value of such shares be determined)?"

HMRC argue that the arrangements were designed to allow subscribers to claim income tax relief greater than their cash investments. They contend that the price of 48p per share was in excess of their open market value for tax purposes. Consequently, HMRC amended Jonathan Netley's return by a closure notice dated 30 September 2010 to reflect their view that the shares were valued at 8p, reducing the tax relief from £15,866 to £2,624.

Decision

Having considered the arguments submitted on valuing shares, the First Tier Tribunal decided that Frenkel Topping Group Plc 's shares should be valued on the basis of the information available to the prudent prospective purchaser. Information as to future prospects would not have been available and so should be ignored.

The Tribunal found that the value of the shares on 28 July 2004 was 17.5p, the value at which shares were allotted shortly before flotation.

They said that:

> 'Share valuation is in many respects an art not a science and in some cases has been described as "intelligent guesswork". '

The appeal was partially allowed.

Jonathan Netley v HMRC (TC 05904)

Capital Taxes

Permitted grounds for PPR

Summary – The Tribunal identified the 'permitted area' for the purpose of principal private residence relief (PPR) (and calculated the gain on the element that was not eligible.

The Ritches acquired land in July 1987, planning permission for a house was granted in 1991, construction of the property commenced in 1992 and the family finally occupied the house as a residence in 1995. There was an old agricultural shed on the site that was used by the Ritchies during the period of ownership.

In June 2006 the Ritchies were approached by property developers who wished to build an estate on the land behind the Ritchies' land, and needed their land for access. They were prepared to offer £2,000,000 for the whole of the land. The Ritchies accepted the offer and on 19 January 2007 the transaction was completed.

In 2013 HMRC issued two discovery assessments to each of the Ritchies in relation to their personal income tax returns for 2006-07, both relating to the property sale.

1. Gain made by each on the sale of their house arising from the land sold in excess of the permitted 0.5 hectares;

2. Gain arising due to the long pre-occupation period..

This case involved both a substantive and procedural issue.

The substantive issue was whether on the sale of their house, the Ritchies were taxable on the area of the gardens and grounds considered to be in excess of the permitted area.

The procedural issue was whether HMRC were entitled to assess the Ritchies to recover the CGT said to be due. This issue arose because the assessments were made more than four but less than six years from the end of the year of assessment 2006-07 in which the gains accrued.

Decision

The First Tier Tribunal stated that the permitted area required for the reasonable enjoyment of the residence should be equated with necessary, not just desirable. The question was, therefore: what amount of garden and grounds is necessary for the enjoyment of the house?

The First Tier Tribunal included the shed and the path that approached it, but not land lying on the other side. In deciding how to apportion the gain between the permitted and unpermitted areas, the Tribunal found that all of the land was of equal value to a developer.

The Tribunal accepted that HMRC were entitled to raise the assessment when they discovered that the Ritchies had not self-assessed themselves to CGT. In order to raise assessments after four years but before the end of six years, they had to establish carelessness by each of the Ritchies.

They found that the Ritchies' advisers had been careless in advising them that 'no mention of the transaction needed to be made' and so, as the advisers had been acting on behalf of the Ritchies, this meant that the assessments had been issued on time.

Mr William & Mrs Hazel Ritchie V HMRC (TC05911)

Deductibility of expenses on sale of properties

The Hanif brother's owned a number of properties jointly which were let out. They had been acquired piecemeal over time and had been subject to various loans from different lenders. At some point, the brothers decided to consolidate the loans into a single facility. The borrowers were the brothers and Mrs Hanif, although it was accpted by all parties that Mrs Hanif had no equitable interest in the properties or lettings business.

The brothers decided to sell two of the properties, and did so with the bank's permission. They intended to use the proceeds of sale to reduce the loan but, for reasons Mr Hanif did not understand, the bank kept the proceeds of sale in a separate account and did not use them to reduce the amount of the loan. The bank then claimed that the Hanifs were in breach of the terms of the loan, as the rental income, once reduced by the sale of the two properties, dropped to less than a predetermined percentage of the interest. In the hanif brotehrs' view, the bank's decision to keep the proceeds of sale in a separate account created the situation in which they were put in breach of the conditions of the loan.

7. The bank appointed a receiver on 19 November 2009 because of the alleged breach of conditions by the Hanifs. The Hanifs instructed solicitors. They were advised that they would be unable to get an injunction to prevent the receiver selling the properties.

The Hanifs instructed another firm of solicitors (Neumans LLP) in December 2009 to advise them on making a claim against the bank. Neumans invoiced them for their services in November 2010.

The receiver sold the properties in May 2010 and the brothers were given a summary of their loan position with the bank in December 2010. In particular, the bank deducted from the sale proceeds the amount of the loan and various expenses, including the receiver's fee. This left an amount of £113,378.04 that the bank claimed that the Hanifs owed to the bank, and the bank lodged a claim in the High Court against the brotehrs for this amount on 16 December 2011.

The Hanifs defended this claim and issued a counter-claim against the bank for damages arising from alleged mis-selling by the bank of the loan agreement. They instructed another firm of solicitors in September 2012, Sky Solicitors, to act for them and Sky continued to act for the Hanifs until an out of court settlement was reached with the bank in April 2014. Sky then invoiced the Hanifs for their services.

The sale of the original two properties was declared on their tax returns but Mr L Hanif agreed that he and his brother had overlooked the need to declare the sales of the remaining eight properties in their tax return. This oversight was perhaps to some extent understandable in that those eight properties were sold by the receiver appointed by the bank and without the Hanifs' consent.

Following the discovery assessment issued by HMRC, the brothers claimed that the calculation of their gains should have taken into account their share of the following:

1. Receiver's fee of £34,075.00;
2. £1,725 counsel's fee;
3. Neumans LLP's fee of £23,433.02; and
4. Sky Solicitors' fees £76,573.33.

Decision

The First Tier Tribunal found that:

1. The receiver's fee was disallowed as it was not incurred wholly and exclusively as a cost of disposal because it was more likely than not to have been in respect of more than just selling the properties. Moreover, the receiver's fee did not fulful the criteria that it was 'paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal adviser' as in fact the receiver acted for the bank and not for the brothers..

2. Counsel's fee was disallowed. This was incurred in seeking advice on obtaining an injunction to prevent the receiver selling the properties. It was a cost to prevent disposal and a cost incurred in defending their title.

3. The Neumans work did not have anything to do with the sale and the Tribunal did not accept that the expenditure fell within s 38(1)(b) as defending the brothers' title to the property: the brothers' ownership of the properties was not in dispute. The fees appeared to be incurred with respect to advice on the brothers' rights and liabilities under the loan agreement and not their title to the properties.

4. The Sky solicitors fees were disallowed. The properties were sold in 2010; the litigation in 2012 was not concerned with the brothers' title to the properties but their rights and liabilities under the loan agreement with the bank.

The appeal was dismissed

Liaqat Haroon Hanif And Rifaqat Haroon Hanif v HMRC (TC05940)

When does ownership of a residence commence? (Lecture P1023 – 15.30 minutes)

The First-Tier Tribunal case of *Higgins v HMRC (2017)* concerned the availability of principal private residence relief under Ss222 and 223 TCGA 1992. It is another in the long line of principal private residence tax cases which have come before the Tribunals and Courts in recent years and will be of particular interest to those practitioners advising clients about the sale of off-plan main residences.

Key facts

In 2004, the taxpayer (H) paid a reservation deposit of £5,000 for an apartment that was being created out of the former St Pancras Station Hotel but which, at that time, was yet to be built.

On 2 October 2006, when issues relating to the site's title had been resolved, H entered into a contract with the seller for the grant of a lease over the apartment (which had still not been started) for a total consideration of £575,000. This was to include two further deposits which, if not paid, would have allowed the seller to rescind the contract. A final payment was of course due on completion.

H sold his previous residence in July 2007 and from then until he obtained possession of his apartment he stayed with his parents and also occupied a rental flat that he owned where the tenant had moved out. HMRC accepted that all these arrangements were temporary ones.

Work finally began on the construction of H's apartment in November 2009 following delays over funding issues that affected the seller but, by mid-December 2009, H was informed that the property had been substantially completed.

H, although allowed access to the building to look round, had no right to occupy his property until 5 January 2010 when his purchase went through.

Exactly two years later on 5 January 2012 H completed the sale of this apartment to a new owner. He had exchanged contracts with the buyer on 15 December 2011.

HMRC did not challenge the amount of H's gain on the disposal in 2011/12 and they accepted that principal private residence relief was available as a result of S223(1) TCGA 1992 which states that no part of a gain is chargeable to tax where the property has been the taxpayer's only or main residence throughout his period of ownership. Where the two sides differed was over the period of ownership for which relief was due.

In other words, HMRC were arguing that there should be a restriction on the principal private residence relief which resulted in a CGT liability of more than £61,000 becoming payable, on the ground that there was a period of time during H's ownership when he had *not* occupied the apartment as a main residence. This, in turn, boiled down to a question of when H's occupation of the property was deemed to commence for CGT purposes.

HMRC's argument was that the qualifying period of ownership should not necessarily be confined to periods when H could first occupy the property. In their view, the period of ownership commenced on the date when the contract to acquire the lease was signed (2 October 2006), and *not* on 5 January 2010 when H actually took up residence.

HMRC considered that relief from CGT should be limited to increases in value during the period of occupation as a residence.

Any increase in value before H occupied the apartment should not, they said, be covered by principal private residence relief. ESC D49 allows a period of up to two years in exceptional circumstances to be treated as a period of occupation, but the delay in H's case comfortably exceeded this time limit and so ESC D49 was not in point – see also Paras CG65003 and CG65009 of the Capital Gains Manual.

On the other hand, H's barrister reasoned that the period of ownership in relation to these rules began on legal completion when the lease to the apartment was granted to H, ie. on 5 January 2010 (and not beforehand). Furthermore, when Ss222 and 223 TCGA 1992 are construed purposively to the facts and viewed realistically in line with the House of Lords' decision in *Barclays Mercantile Business Finance Ltd v Mawson (2005)*, the period of ownership must, as a matter of logic, be confined to the period when the apartment existed and was available for occupation. Under his contract, H had no right of occupation until completion of the grant of the lease on 5 January 2010. Using S28 TCGA 1992 (which is what HMRC wanted to do) cannot displace the substantive principal private residence provisions. On this basis, the impact of ESC D49 was irrelevant. It would be unjust, the barrister argued, to deny H relief from tax on a gain on his apartment, given that it had been occupied as soon as it was legally and realistically available up to the time of its eventual disposal.

Having considered all the arguments, the First-Tier Tribunal decided that principal private residence relief was indeed available for the entire capital gain realised by H on the sale of his apartment.

Their reasoning

The meaning of 'period of ownership' for a residential property begins on the date when the purchase has been physically and legally completed and the purchaser has the right to occupy.

H was entitled to full relief. He took up his occupation of the apartment as soon as he was able. The fact that there was such a lengthy delay before he did so was through no fault of his own. He then remained resident there until the sale.

S28 TCGA 1992 identifies the acquisition and disposal of a chargeable asset, but it does not directly determine the meaning of 'period of ownership' in the context of the availability of principal private residence relief. If the draftsman of the CGT legislation had wanted to say that S28 TCGA 1992 determined the meaning of 'period of ownership', it would have been relatively simple to have incorporated that requirement into the statute.

To argue that a period of ownership can begin when the contract to acquire the property is entered into but the individual has no right to occupy until a later date would be perverse in the extreme. The First-Tier Tribunal did not accept HMRC's line that H had ownership of the apartment from the date of the contract – this was simply impossible, given that the property did not exist at that time. The contract was to buy a lease of the finished apartment.

The period of ownership for principal private residence relief purposes began when H acquired a legal and equitable interest in the lease and a legal right to occupy the property – this was on 5 January 2010. As the apartment was then used as his main residence until its sale on 5 January 2012, relief was due on the whole gain.

As mentioned earlier, this decision will be of interest to those involved with off-plan property purchases which are becoming increasingly common, in view of the fact that delays can often occur before the buyer takes up residence. The First-Tier Tribunal took a purposive and pragmatic view in relation to the facts, dismissing HMRC's technical argument about S28 TCGA 1992. For once, this worked in favour of the taxpayer.

Contributed by Robert Jamieson

Reorganisation scheme failed

Summary – A scheme intended to operate as a reorganisation within the scope fo SS 126 – 130 TCGA 1992 should be treated as two separate conversions, so that the scheme did not have the effect of allowing frozen gains on non-QCBs to escape capital gains tax.

Mr and Mrs Hancock had sold the entire share capital of their company, Blubeckers Ltd, to another company receiving loan notes issued by the purchasing company.

- One tranche of loan notes provided for a repayment in US dollars at an exchange rate other than the one prevailing at the date of redemption and so qualified as a non-QCB.

- A second tranche of loan notes depended on the subsequent performance of Blubeckers Ltd . This second tranche when received were QCBs.

Both sets of loan notes were exchanged for two secured discounted loan notes, which were QCBs and were eventually redeemed for cash.

The Hancocks contended that there had been a single conversion being the conversion of both QCB and non-QCB loan notes into a single QCB loan note so that the original gain on sale of their shares had been rolled into exempt QCBs.

The Upper Tribunal decided that the conversion of loan notes was treated as a reorganisation as a result of s132 TCGA 1992 so that each exchange of loan notes was treated as a separate transaction rather than part of a single transaction. This resulted in the accrued gains on the original non-QCB being taxable.

Decision

The Court of Appeal said that the reorganisation provisions (S127 to s130) did not apply directly to the taxpayers' case, as these sections required shares on the input side and shares or debentures on the output side. The Hancocks' transaction involved QCBs and non-QCBs on the input side and not shares.

However, s 132(1) provides for the applications of ss127 to 131 'with any necessary adaptations' in relation to the conversion of securities. The court therefore wondered whether, in a conversion of securities, as distinct from a reorganisation, it is permissible to aggregate securities together, so that the input side of a conversion may include both taxable and exempt securities. When considering whether this was the right approach, it examined the impact of permitting the aggregation of fiscally different inputs on the operation of the scheme as a whole.

If the Hancocks' argument was correct, transactions which include QCBs and non-QCBs on the input side and QCBs on the output side are excluded from the operation of s 116 by s116(1)(b). The effect would be that the chargeable gain which had accrued on the non-QCBs would escape CGT altogether.

This would be, as Neuberger J put it in Jenks [1997] STC 853, 'contradictory to the evident purpose of the relevant statutory provisions'. This was therefore not the right reading of s 116.

This unsuitable result would, however, not be possible if the conversions of QCBs and non-QCBs were treated separately because of their different tax status, as s 116(1) (b) would not block the application of s 116 to those separate transactions. This was justified as a 'necessary adaptation'.

A and T Hancock v HMRC [2017] EWCA Civ 198 (25 May)

Tax Journal (2 June 2017)

Redemption in specie

Summary - Exemption from stamp duty reserve tax (SDRT) did not apply to a unit holder's redemption of units in a fund where the distribution of securities to the unit holder was not proportionate to, or as nearly as practicable proportionate to, his share in the fund

A redemption in specie occurs in a unit trust scheme when a unit holder surrenders units to the scheme manager and receives a distribution of securities rather than cash in return. The issue in this case was the amount of stamp duty reserve tax (SDRT) payable in respect of a redemption in specie by a unit holder in a unit trust scheme managed by Henderson UK Enhanced Equity Trust.

At the time of the relevant redemption, Para 2 Sch. 19 FA1999 where a unit holder disposed of any part of their interest in a unit trust scheme, SDRT of 0.5% of the market value was due. However, Paragraph 7 Sch. 19 sets out an exclusion from this charge for a redemption in specie where the unit holder “received only such part of each description of asset in the trust property as is proportionate to, or as nearly as practicable proportionate to, the unit holder’s share.”

In this case, a pension fund trustee‘s interest in the Trust was 27.41% but the securities received on redemption represented an interest of 28.68% so an over-allocation of 1.27%.

Henderson argued that Paragraph 7 operated to provide an exclusion from charge to SDRT on a redemption in specie to the extent that there was no change in the beneficial ownership of the securities received by the Unit Holder with the result that in this case SDRT was due under only by reference to the proportion of the market value of the unit surrendered which were attributable to the over allocation of securities of 1.27%.

HMRC’s position was that Paragraph 7 provided an “all or nothing” or “hard edged” exclusion. Consequently, in its view, as the transfer of the relevant securities on the redemption was not proportionate to, or as nearly as practicable proportionate to, the Unit Holder’s share in the Scheme, an SDRT charge was due by reference to the market value of all of the units surrendered, subject to any other applicable reduction in charge.

Decision

The Upper Tribunal found that the effect of Paragraph 2 Schedule 19 was that a transfer in specie on redemption where the conditions for the exclusion set out at Paragraph 7 Schedule 19 were not met, was that SDRT was payable in respect of the market value of all of the assets transferred.

Henderson Investment Funds Ltd v The Commissioners for HM Revenue and Customs: [2017] UKUT 0225 (TCC)

Share loss relief/negligible value claims by personal representatives
(Lecture P1025 – 9.10 minutes)

S131 ITA 2007 provides income tax relief where a person, who has subscribed for shares in an unquoted trading company, subsequently disposes of those shares at a loss – this situation includes a deemed disposal under S24(2) TCGA 1992 where the shares have become of negligible value.

The recent Upper Tribunal case of *HMRC v Leadley (2017)* considered just such a claim and the issue was: if the owner of the shares dies before making the relevant claim, can the claim still be made by his personal representatives?

The taxpayer (L) had invested £25,000 in each of two companies called Datalase Ltd and Keronite Ltd. However, by 5 April 2010, both these shareholdings had become valueless. L's tax return for 2009/10 would ordinarily have been filed by 31 January 2011, but tragically L was killed in a car accident on 11 May 2010 (when of course he had not yet submitted his tax return).

In January 2011, L's personal representatives filed a tax return reporting the deceased's chargeability to tax for 2009/10. This included a share loss relief claim under S131 ITA 2007. HMRC contended that the personal representatives were not entitled to make the claim on the ground that only the person who owned the shares could make the claim. And, sadly, he was dead – so no joy.

The personal representatives' response was to point out that they owned the shares at the time when the S131 ITA 2007 claim was made and so please could they have the relief. No, said HMRC, by the time when the personal representatives acquired the shares, the investments had already become of negligible value so that the personal representatives still could not make a valid claim.

Back in 2014, the First-Tier Tribunal decided that the personal representatives *did* have a valid claim on the ground that they 'stand in the shoes of' the deceased and are therefore able to make the same claims as the deceased could have made were he still alive.

The essential point which emerged is that, in order to make a valid claim under S131 ITA 2007, it is necessary for the person who owns the shares at the relevant time to make the claim. Accordingly, the personal representatives need to be treated as the person who owns the shares for this purpose – if they cannot be so treated, they cannot make the claim.

Although the First-Tier Tribunal held that this was the case, HMRC disagreed and appealed against the ruling. The Upper Tribunal also disagreed. They stated that the deceased and his personal representatives cannot be equated. In support of this conclusion, the Upper Tribunal cited S62 TCGA 1992 which treats the two sides as distinct and provides for personal representatives to be deemed to acquire the assets of a deceased person on his death for a consideration equal to their market value, but without there being a disposal for CGT.

This verdict was neatly summed up by one commentator who said:

> ‘We hear a lot about purposive interpretations when HMRC seek to deprive a taxpayer of a relief, but, sadly, they never seem so keen on purposive interpretations when they benefit the taxpayer. The First-Tier Tribunal thought that a purposive interpretation was appropriate here, but, unfortunately for the (personal representatives), the Upper Tribunal took a different view.’

Contributed by Robert Jamieson

Negligible value claim

Summary – Mr Ward made a valid negligible value claim even tough he never specifically referred to a ‘negligible value claim’.

Mr Ward’s self-assessment tax return for 2010/11 declared income received of £325,863, less losses of £261,735, which included £194,500 in respect of a negligible value claim.

HMRC claim that Mr Ward failed to lodge his claim correctly, within the relevant time period.

The claim related to losses suffered on the disposal of shares in Ticktock Entertainment Limited when it was liquidated in 2010. 19,500 shares were acquired for £19,500 in 2007 and 8,750 shares acquired in 2008 for £175,000, totalling £194,500.

Mr Ward claims that on 12 May 2011 he emailed HMRC via the HMRC website, lodging a claim for relief. He made this claim before signing the transfer of the shares. However, he did not specifically make reference to a negligible value claim, nor did he include calculations or supporting evidence to quantify the claim. However, his claim was accompanied by a postponement application in an amount equivalent to the £194,500 share loss allowance being claimed.

On 12 June 2014 HMRC wrote to Mr Ward acknowledging that on 12 May 2011 he had disposed of his 28,250 shareholding in Ticktock Entertainment Ltd but advised that for a valid negligible value claim to be made, the asset of negligible value had to be owned at the time the claim was made. HMRC requested a copy of the stock transfer agreement, but advised that they proposed to disallow the claim. Their view was that Mr Ward had disposed of the asset on 12 May 2011, and the negligible value claim had not been properly quantified at the time it was made. Therefore, the claim was not valid. No claim could be made after that date as he was no longer the owner of the asset.

On 23 December 2015 HMRC issued a Closure Notice for 2010/11 in accordance with s 28A (1) and (2) TMA 1970 reflecting additional tax due of £91,888.30, along with an inaccuracy penalty of £27,566.49.

Mr Ward appealed HMRC’s decision to disallow his claim.

Decision

The First Tier Tribunal accepted that immediately prior to sale of his shares, Mr Ward made a negligible value claim, by way of an online request to reduce payments on account saying that “The Tax Allowances and reliefs have gone up”. It was clear that he was referring to his share loss relief claim and he provided the figures in his postponement application.

The claim was therefore quantified and the claim was valid.

The appeal was allowed.

Richard Steven Ward V HMRC (TC05919)

HMRC's non-statutory clearance service

HMRC updated Annex C to its non-statutory clearance service guidance on 13 June 2017.

Under the section entitled *When HMRC will not provide advice under this service* has been updated and explains that HMRC will confirm the reason why advice requested has not been provided. The guidance now specifies that HMRC will not give clearances in respect of the ‘settlements legislation’, or the execution of non-charitable trust deeds or settlements.

Annex C containing the ‘Business Property Relief checklist’ has also been updated.

www.gov.uk/non-statutory-clearance-service-guidance

Administration

HMRC revises reporting requirements for employment intermediaries

On 12 June 2017 HMRC updated their guidance with a new section 4.3 for intermediaries on appealing against penalty notices issued for submission of late or incorrect reports.

Intermediaries must appeal in writing and send it to the address shown on the penalty notice, quoting the charge reference, customer reference and name of the company on the letter.

HMRC have 30 days to respond and will suspend any action to collect the penalty charge amount until after a decision is made. They will suspend collection of the penalty until a final decision has been made.

When a final decision has been made and there is no further right of appeal HMRC will pursue collection of the outstanding debt.

www.gov.uk/government/publications/employment-intermediaries-reporting-requirements

Pension schemes newsletter 87

This edition of the newsletter was published on 1 June 2017 and covers five areas.

1. *Pension advice allowance*

HMRC has confirmed that:

- although the Registered Pension Schemes (Authorised Payments) (Amendment) Regulations, SI 2017/397, requires that requests for the pension advice allowance must be made in writing by members, member can make this request by email;
- pension scheme administrators must decide if they will accept requests by email.

2. Relief at source

Pension schemes operating relief at source must submit their annual return of individual information for 2016/17 to HMRC by 5 July 2017.

Interim repayments will be delayed where a return is submitted late or fails processing. Once a successful return is submitted, interim repayments will be made.

3. Scottish rate of Income Tax

In May 2017 HMRC published the Pension schemes Scottish rate of Income Tax newsletter that gives scheme administrators operating relief at source information about submitting the annual return of individual information to HMRC from 2018 onwards and the digital channel, Secure Data Exchange Service (SDES), tat will be used to submit this information.

The newsletter also gives information about how pension scheme administrators operating relief at source pension schemes of individual scheme members' residency tax status from January 2018 onwards.

4. Confusing the pension scheme return and the SA970 tax return

HMRC have received a number of queries from scheme administrators confusing the pension scheme return (PSR) with the SA970 tax return for trustees of registered pension schemes.

- The PSR provides HMRC with information about the scheme, including information on contributions to the scheme, transfers, pension scheme investments and investment income. You need to complete and submit a PSR online if issued with a notice to do so.

- Trustees of a pension scheme that has previously paid tax or claimed a repayment will be issued with a letter telling them that they must complete a SA970 tax return for the pension scheme.

5. Recognised Overseas Pension schemes (ROPS) notification list

Following recent changes to the pension tax rules relating to overseas pension schemes, there are changes planned to the scheduled publication of the ROPS notification list:

- 2 June 2017 - ROPS notifications list suspended

- 5 June 2017 - Updated list published

- 15 June 2017 - Routine publication of the ROPS

www.gov.uk/government/publications/pension-schemes-newsletter-87-may-17

National courts and exchanges of information courts

Summary – When a tax authority receives an information request from another tax authority, it is required to check whether the information sought has 'foreseeable relevance' and that the national courts have jurisdiction to oversee that process.

Berlioz was a joint stock company governed by Luxembourg law, which had received dividends from its subsidiary, Cofima, a French company, free of withholding tax. The French authorities, questioning whether the exemption actually applied, had sent a request for information to the Luxembourg Tax Administration, which had then sought the relevant information from Berlioz. Berlioz had refused to communicate some of the information requested and as a result a fine had been imposed.

Berlioz appealed and the fine was reduced but its request for annulment of the information order was denied.

The issue was whether it should be allowed to challenge the legality of the information order in the context of an exchange of information between national tax administrations.

CJEU Decision

Berlioz was entitled to challenge the legality of the information order as it was entitled to protection against arbitrary or disproportionate intervention by public authorities. To be legal, the information requested needed to have 'foreseeable relevance' (Directive 2011/16 Arts 1(1) and 5). The requesting authority must therefore provide an adequate statement of reasons explaining the purpose of the information sought.

Berlioz Investment Fund SA v Directeur de l'administration des contributions directes (Case C-682/15) (16 May)

Tax Journal (26th May 2017)

Updated guidance: HMRC's worldwide disclosure facility

In September 2016 HMRC launched its worldwide disclosure facility for voluntary disclosure relating to UK tax liabilities relating to offshore interests.

In June 2017, they have updated their guidance for taxpayers wishing to use the new worldwide disclosure facility. In complex cases, taxpayers may apply for up to 90 additional days in which to make a disclosure, giving up to 180 days in total. A check box has been added to the disclosure form for taxpayers to declare if they are receiving tax credits.

www.gov.uk/guidance/worldwide-disclosure-facility-make-a-disclosure

APN notice – procedural failure by HMRC

Summary - penalty imposed for non-compliance with an APN stating two different amounts of tax due was not due.

In the tax year 2007-08, the taxpayer had employment income of £127,800 plus benefits from which income tax was deducted through the PAYE system. He also entered into a tax avoidance scheme called “Liberty 2 (Syndicate)” looking to generating a loss for 2007-08 and claim a repayment of £39,641.

On 9 December 2009 HMRC opened an enquiry into his 2007-08 return and referred specifically to the taxpayer’s claim for loss relief.

In 2008 the taxpayer had been arrested on suspicion of conspiracy to defraud and was finally convicted in 2011, serving a custodial sentence following his conviction. While in prison, HMRC had written to the taxpayer in March 2015, informing him of their intention to issue an APN in respect of his use of the Liberty 2 scheme in relation to 2007-08.

In a letter dated 23 July 2015 HMRC enclosed a document with a banner heading “Accelerated payment notice issued under Part 4, Chapter 3 of the Finance Act 2014” stating the amount covered by the notice was £56,905.20. However, in a section headed “How to pay”, the “Amount due” was stated as £53,063.70. Clearly this was a different amount from the figure of £56,905.20 specified right at the start of the notice as the “Amount due in respect of this notice”.

The appeal concerned whether:

- the APN in question was 'given' to the appellant;
- his liability to a penalty should be affected by claimed rights to repayment of tax; and
- the appellant had a reasonable excuse for non-payment.

Decision

The Tribunal found that the APN had been served; HMRC had sent it by post to the taxpayer's known place of residence and it had been delivered at that address.

They also found that the taxpayer had no right to have a claimed repayment from an earlier year set off against the accelerated payment in a situation where the return that gave rise to the claimed repayment was still under enquiry.

Reasonable excuse was not established. An insufficiency of funds could only represent a reasonable excuse in circumstances where that insufficiency was 'attributable to events outside the appellant's control'. The taxpayer's conviction, resulting in lack of funds were attributable to the taxpayer's own conduct.

However, legislation requires HMRC to "specify the payment... required to be made" in the APN but it stated two different amounts of tax payable.

The tribunal noted:

> 'Where HMRC ….. specify two different amounts to be paid, they place the recipient in an impossible position. Should he pay the lesser amount, in the hope that it is sufficient, or should he pay the higher amount, even though HMRC appear to be saying they will accept the lesser amount?'

They concluded that:

> 'HMRC's decision that a penalty is payable is unsustainable and accordingly HMRC's decision to impose a penalty should be cancelled pursuant to paragraph 15(1) of Schedule 56 to Finance Act 2009.'

The appeal was allowed because of a procedural failure by HMRC.

Graham Pitcher v HMRC (TC05870)

Online filing at the end of a company's life

HMRC has updated its guidance on when companies being formally wound up will be exempt from mandatory online filing and can choose to file a paper return.

Exemptions from online filing

There is a legal exemption for insolvent companies who don't have to file their Company Tax Returns online (SI 2009/3218) if they're:

- subject to a winding up order
- in formal administration
- in administrative receivership

This exemption includes:

- creditors' voluntary liquidations
- company voluntary arrangements
- provisional arrangements under a court order

This exemption applies to any outstanding Company Tax Returns for periods:

- before the start of the winding up
- before appointment of the Insolvency Practitioner (IP)
- within the period of the winding up procedure

Informal dissolution and MVL for solvent companies

The exemption doesn't apply to solvent dissolution where you seek informal striking off or enter a MVL. There may be tax risks to consider as a result of the cessation and striking off, so a full online Company Tax Return may be needed.

www.gov.uk/government/publications/corporation-tax-mandatory-online-filing-and-the-end-of-a-companys-life

Financial institutions, bank and building society returns for 2017/18

On 12 June 2017 HMRC issued two sets of guidance relating to reporting interest for 2017/18:

Financial institutions

These guidance notes relate to the annual return financial institutions (other than banks and building societies) must make to HMRC giving information about interest earned or credited to accounts of UK residents.

Returns for 2017/18 onwards only need contain data about people who live in the UK, as the common reporting standard has now replaced the EU savings directive and fully-reportable countries list.

www.gov.uk/government/publications/european-union-savings-directive-eusd

Banks and building societies

These guidance notes concern the annual return banks and building societies must make to HMRC giving information about interest earned or credited to accounts of UK residents.

Like financial institutions, returns for 2017/18 onwards only need contain data about people who live in the UK.

www.gov.uk/government/publications/european-union-savings-directive-eusd

Queen's Speech 2017

The Queen’s speech on 21 June introduced an extended two-year session of Parliament, in order to cope with the volume of legislation expected to arise from Brexit. This includes 27 bills, of which eight are dedicated entirely to measures around the UK leaving the EU, including the Repeal Bill and a Customs Bill. There will also be a Summer Finance Bill and a National Insurance Contributions Bill.

Customs Bill

This Bill will provide new domestic legislation to replace EU customs legislation and modify elements of the indirect taxes system, allowing the UK to operate a standalone customs and indirect taxes regime on exit from the EU, whatever the outcome of the negotiations.

Summer Finance Bill

At present the timeframe and content are unknown. We wait to see how many of the provisions that were dropped ahead of the June general election are reinstated and if reinstated, will start dates be changed.

www.gov.uk/government/publications/queens-speech-2017-background-briefing-notes

Deadlines

1 July 2017

- Corporation tax payable for p/e 30 September 2016, if not liable to pay by instalments.

5 July 2017

- Submission of Non-resident landlords' scheme 2016/17 returns.
- Date to report non-cash benefits not from a registered pension scheme.
- PAYE settlement agreements for 2016/17 must be finalised.

6 July 2017

- Forms P9D, P11D, P11D(b) for 2016/17 must be filed.
- Due date to provide employees with 2016/17 benefits information.
- 2016/17 reporting deadline for third party benefits.
- Deadline for registering 2016/17 share schemes and file reportable events

7 July 2017

- Due date for VAT return and payment for 31 May 2017 (electronic payment).
- Return of 2016/17 non-cash benefits provided to retired employees under employer-financed retirement benefit schemes.

14 July 2017

- Due date for CT61s for quarter ended 30 June 20167
- Due date for monthly EC sales list if paper return used.

19 July 2017

- Pay PAYE/CIS for month ended 5 July 2017 if by cheque by this date.
- Payment of 2016/17 Class 1A NICs by cheque due by this date.

22 July 2017

- Due date for PAYE/NIC/student loan payments if being paid online.
- Pay 2016/17 class 1A NICs electronically by this date.

31 July 2017

- 2016/17 second instalment SA liabilities are now due.
- Second 5% surcharge for unpaid 2015/16 SA tax / class 4 NIC balancing payments due.
- Tax credits claims renewed by this date.
- Accounts of private companies with 31 Oct. 2016 year ends filed at Companies House .
- CTSA returns for accounting periods ended 31 July 2016 due by this date.
- Annual adjustment for VAT partial exemption claims, April year end by this date.

News

More updated HMRC Toolkits issued

At the end of May HMRC issued a number of updated Toolkits. Remember the use of these Toolkits is voluntary:

- HMRC Toolkit: Private and Personal Expenditure (2017): relevant for self-assessment returns for 2016/17.

  www.gov.uk/government/publications/hmrc-private-and-personal-expenditure-toolkit

- HMRC Toolkit: Income Tax Losses (2017): relevant for self assessment returns for 2016/17.

  www.gov.uk/government/publications/hmrc-income-tax-losses-toolkit

- HMRC Toolkit: Capital Allowances for Plant and Machinery (2017): relevant for 2016/17 self assessment and company tax returns.

www.gov.uk/government/publications/hmrc-capital-allowances-for-plant-and-machinery-toolkit

CRS avoidance disclosure facility prompts action in Hong Kong

The OECD's disclosure facility for CRS avoidance schemes, launched in May, has so far caused the Hong Kong authorities to take action and has alerted the OECD to schemes in a number of other jurisdictions.

On 5 May, the OECD launched a public disclosure facility for information on schemes designed to circumvent the application of the Common Reporting Standard (CRS).

Several submissions highlighted the use of Occupational Retirement Schemes (ORS) in Hong Kong, China to avoid reporting under the CRS. The Hong Kong authorities have taken action, issued relevant guidance on the inland revenue website to clarify that only certain registered ORSs are out of scope of CRS reporting and are assessing whether further action is required in this respect.

The OECD is also in close contact with a number of jurisdictions in order to assess whether other schemes that have been disclosed through the facility (including a number of residence by investment programmes) may pose an actual risk for avoiding CRS reporting and therefore need to be addressed.

Anyone with knowledge of schemes that purport to circumvent the application of the CRS are encouraged to come forward and make use of the disclosure facility which can be accessed through the Automatic Exchange Portal.

www.oecd.org/tax/the-fight-against-offshore-tax-evasion-continues-crs-disclosure-facility-delivers-first-results.htm

Business Taxation

Terminal loss relief claim (Lecture B1021 – 5.06 minutes)

Summary - A terminal loss relief claim was not a stand-alone claim which required an enquiry separate from the enquiry into the final return.

Spring Salmon and Seafood Ltd supplied seafood from about May 1998. S&R Partnership began trading as consultants in about September 1998. In July 2002, it purported to sell its business to *Spring Salmon and Seafood Ltd* for £2,835,000 of which £2,800,000 was attributed to goodwill. *Spring Salmon and Seafood Ltd* ceased trading at or about the end of January 2005. On filing their returns they looked to claim relief for terminal losses largely created by goodwill amortisation.

HMRC opened and closed an enquiry. Closure notices for the 2004 and 2005 returns concluded that *Spring Salmon and Seafood Ltd* was not entitled to relief for goodwill amortisation and this was therefore disallowed. The notices did not use the phrase *terminal loss relief.* What they said was that the loss reflected in the corporation tax computations submitted by *Spring Salmon and Seafood Ltd* for the 18 months to 31 January 2005 was £2,819,065, of which £2,394,521 was claimed to be for relief for goodwill amortisation. As the goodwill had been disallowed, the conclusion in the notices was that the corporation tax loss for the 18-month period was £424,544 and not the sum of £2,891,065 reflected in *Spring Salmon and Seafood Ltd 's* tax computations. The closure notices requested confirmation of how *Spring Salmon and Seafood Ltd* wished to utilise the loss of £424,544.

Spring Salmon and Seafood Ltd contended that its claim to carry back terminal loss relief (which the closure notice dismissed) was a stand-alone claim which could not validly be dealt with under Schedule 18 FA 1998 and required a separate enquiry under Schedule 1A TMA 1970, so that the closure notice had no effect on the claim. The issue was therefore whether HMRC should have opened a separate enquiry under Schedule 1A TMA 1970 in order to challenge the claim for carry back loss relief. They argued that he refusal of the claims had been made following an incompetent process of enquiry and the closure notices had not affected the claims at issue.

Decision

Spring Salmon and Seafood Ltd had tried to separate the amortisation of goodwill that was the asserted foundation for the loss and the claim to carry this loss back, but the Tribunal rejected this argument.

The Upper Tribunal found that the claim for terminal loss relief arose principally from a deduction for goodwill amortisation, which was arose in the final 18-month accounting period. It was properly contained in the returns for this period. The heart of the claim for terminal loss relief was the figure for goodwill amortisation which formed part of the return for the later year and a separate enquiry was not required.

The Tribunal agreed with the First Tier Tribunal that the terminal loss relief claim could not be viewed as a stand-alone claim.

Spring Salmon and Seafood Ltd v The Commissioners for HM Revenue and Customs: [2017] UKUT 0205 (TCC)

Paying tax twice when scheme fails (Lecture B1022 – 6.14 minutes)

Summary – The Tribunal does not have the power to order HMRC to 'set-off' assessments for different taxes in different companies when a tax scheme fails

This case considered the treatment of two tax schemes looking to save PAYE taxes. Both schemes failed.

The first was introduced in November 2000 and to implement it, J H Donald Company Services Ltd ("Services") was incorporated on 13 November 2000 with shares issued to James H Donald (Darvel) Ltd ("Darvel"), a private company, limited by shares, the sole director of whom was Reginald Donald. Under this scheme, employee contractual pay was replaced by earnings at the National Minimum Wage rates. The difference between their pay net of PAYE and NIC according to their contractual rate and their net pay at National Minimum Wage rates was paid to the employee as a dividend from Services.

The second was introduced in October 2005. J H Donald Retail Ltd ("Retail") that had been set up in 2002 and was owned initially by Reginald Donald was used. In March 2006, and on a number of subsequent occasions, shares in Retail were allotted to individuals who were, or had been, employees of Darvel. Reedon Partnership LLP ("Reedon") was incorporated as a limited liability partnership on 16 January 2006. Under this plan, individuals who were shareholders in Retail received dividends and also a profit share as members of Reedon. This plan operated such that the employees who were members of Reedon were allocated profits that were less than their contractual rates of pay. Dividends were then awarded to bring the overall income entitlement to approximately the net amount they would otherwise have received had PAYE and NIC been applied to their contractual earnings.

Darvel's profits were calculated after deduction of all wages and profit share paid to Reedon and Services who in turn paid corporation tax on all profits. Services and Retail submitted self-assessment corporation tax returns, and paid the corporation tax in those assessments, on that basis.

HMRC opened enquiries into Darvel's tax returns that concluded with them issuing assessments to recover unpaid PAYE and NIC.

The appeal asked the question that since the schemes did not work, should Darvel have to account for PAYE and NIC with HMRC also retaining the corporation tax that Services and Retail had paid as part of those schemes?

Decision

The First Tier Tribunal held that corporation tax paid by group members in accordance with a tax avoidance scheme cannot be credited against an assessment for PAYE and NICs ultimately charged on another group member as a result of the failure of the scheme.

The Tribunal confirmed the principle that, where taxpayers enter into unsuccessful avoidance schemes, they cannot complain if the scheme fail and results in their paying tax twice".

James H Donald (Darvel) Ltd, Gordon Davies, Reginald Donald & Ricardo Togneri V HMRC (TC05908)

Purchase and impairment of film rights

Summary - Impairment amounts that related to the expenditure on the film rights were capital in nature and so were not allowable deductions.

This decision is a follow-up to the First-tier Tribunal decision in the main Ingenious Games litigation case (TC5270). Having decided the principle the Tribunal left the parties involved to agree the figures that they were unable to do.

The case considered the dispute over the tax treatment of the provisions made for the impairment of rights under the relevant film financing agreements. These were deductible under UK GAAP but should they be disallowed for tax as capital expenditure under S33 ITTOIA 2005?

HMRC argued that, for GAAP purposes, the rights under the relevant agreements were intangible assets held for use on a continuing basis in the business, so that they were of a capital nature and no deductions could be made in calculating the LLP's profits.

The taxpayer argued that it would be absurd to treat the expenditure on the rights as capital, The LLPs would remain taxable on the gross amounts received without any deduction for the cost of acquiring those amounts.

Decision

The Tribunal had sympathy for the taxpayers' argument. Unfortunately there is 'no warrant for reading the words of the statute differently because accounting practice has changed' and that the meaning of capital 'remains as it was understood more than half a century ago'.

The Tribunal concluded 'with misgivings and reluctance' that the rights were capital in nature. The rights would have a life and would be capable of producing income and would last as long as the business lasted giving them the hallmark of being a capital asset.

The taxpayers' appeal was dismissed. The LLP investors will be deprived their upfront tax relief and will face continuing tax liabilities on the revenues from the films without any deduction for acquisition costs.

Ingenious Games LLP and others v HMRC (TC05893)

Were dollars the functional currency?

Summary – A dollar denominated derivative contract did not change the company's functional currency to dollars.

Ball is a US publically listed company owning an international group of companies, involved in the manufacture of plastic and metal packaging for food, drinks and household products.

Ball UK Holdings Limited is a UK investment holding company whose ultimate holding company is Ball. As an investment holding company, the company made and received loans to and from its subsidiaries and other Ball-group companies which were re-financed on two or three occasions; it received dividends from its subsidiaries which permitted it to fund the interest on its borrowings; in 2005 it paid a dividend (of approximately £43 million) to its immediate parent, a European company.

It undertook all of these activities in sterling with the exception of a short term loan in Euros in 2002 and a derivative detailed below. The loans it made and received were not only in sterling but the interest rates were determined by UK prime rate or LIBOR.

For its first four years, up to 31 December 2005, accounts were all prepared with sterling as its functional currency under SSAP 20. At the end of 2006, on advice from PwC, and with the intention of avoiding tax, the company decided to implement a scheme which it considered would result in it being able to change its functional currency for the year end 2006 to dollars. The aim of the scheme was to trigger the right to move from the SSAP 20 accounting standard to the FRS 23 accounting standard.

To do this, the scheme required Ball UK Holdings Limited to enter into a derivative contract, which it did at the end of December 2006. The transaction was in dollars. Under accounting rules, doing so gave it a choice as to whether to apply fair value accounting, which it chose to do. Applying fair value accounting triggered a requirement to comply with FRS 26, and also FRS 23 (which determined functional currency).

The derivative was worth about $30,000. While both parties and the experts were agreed that entering into the derivative triggered the right to apply FRS23, they were also agreed that the derivative was not significant in amount to Ball UK Holdings Limited (the value of its subsidiaries being about half a billion dollars). Therefore, the experts were agreed that the derivative, while it had triggered the application of FRS23, was irrelevant to the determination of Ball UK Holdings Limited functional currency under FRS23.

Ball UK Holdings Limited then applied – or purported to apply - FRS 23 to change its functional currency in its accounts for 2006 to dollars. That had the effect of generating, on paper at least, a FOREX loss as its assets and liabilities were revalued on the previous year when they had been shown in sterling.

Decision

The First Tier Tribunal found that decisions made by Ball UK Holdings Limited were made by persons acting on behalf of Ball, its ultimate parent company. This included the decision to enter into the derivative contract and then to adopt accounts that showed US dollars as Ball UK Holdings Limited ‘s functional currency.

The Tribunal held that all relevant factors pointed to sterling being the functional currency. It was irrelevant that the decisions which caused all those answers to point to sterling were ultimately taken by Ball and not Ball UK Holdings Limited ‘s, as FRS 23 was not about who made the decisions.

The Tribunal agreed that the test for functional currency is intended to identify the primary economic environment in which the entity operates and all the paragraphs of the FRS should be read with that intention in mind.

The Tribunal decided that activities were carried on with a significant degree of autonomy (in the sense of economic independence) from its parent and ultimate parent: it was not a mere conduit. Its cash flows were not readily available for its parent: on the contrary, dividends from its subsidiaries were largely used to fund its debt obligations.

They decided that it would be more important that the functional currency was one which minimised the FOREX risk in the presentation of the accounts by being the currency to which the company had greatest economic exposure than one which was merely consistent year on year.

The appeal against the assessment is dismissed.

Ball UK Holdings Limited v HMRC (TC05920)

Capital allowances on research

In The Brain Disorders Research Limited Partnership; N Hockin v CRC, Upper Tribunal (Tax and Chancery Chamber), a partnership was set up to undertake scientific research and claim capital allowances on the relevant expenditure.

- The partnership paid, say, £100 to a special purpose vehicle (Numology) to carry out research.
- A third party verified the £100 as the amount required to undertake the research conventionally.
- Numology then subcontracted another company, BRC, to do the work more cheaply, paying it, say £6.

The aim was that, although Numology had paid only £6 to BRC, the partnership would claim capital allowances on the £100 it had paid to Numology.

HMRC said that only £6 qualified for capital allowances and that the partnership's was not trading.

Both the First Tier and Upper Tribunals agreed that:

- only £6 was spent on research and qualified for allowances
- the partnership had not been trading as from the partnership's perspective, the research was no more than a vehicle by which it was hoping to generate huge tax losses.

However, the judge said, even though the agreement was a sham, it was a tax avoidance or deferral scheme but did not constitute evasion. There had been no attempt to conceal what happened.

The taxpayers' appeal was dismissed.

Taxation magazine (8 June 2017)

EU adopts extended directive on hybrid mismatches

In June 2016 the EU Council issued Council Directive (EU) 2016/11641, the Anti-Tax Avoidance Directive, targeting BEPS (Action 2): Neutralising the Effects of Hybrid Mismatch Arrangements but only for EU member states and not third countries.

Shortly after in July 2016, the Council stated its aim to agree on rules to cover hybrid mismatches involving non-EU countries and in October 2016, the Commission released an amended draft of the Directive to address such mismatches. The directive was adopted at a meeting of the Competitiveness Council, without discussion that followed an agreement at a meeting on 21 February 2017. The European Parliament gave its opinion on 27 April 2017.

On 29 May 2017 the EU Council adopted the amended anti-tax avoidance directive that extends the hybrid mismatch rules to cover arrangements with non-EU countries.

Article 1 of Directive (EU) 2016/1164 now reads:

Scope

This Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, with Article 1 now reading:

1. This Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country.

Edward Scicluna, Council president said:

> “Our aim here is to tackle one of the main practices that multinational companies have devised to reduce their tax bills”.
>
> “The directive adds to the rules we adopted last year to tackle the most common forms of tax avoidance. It will also ensure implementation of the OECD’s recommendations.”

Mismatched outcomes

Where mismatch outcomes represent a hybrid mismatch, Member States must disallow payments, expenses or losses or include payments as taxable income.

A mismatch outcome is not treated as a hybrid mismatch unless it arises between associated enterprises, between a taxpayer and an associated enterprise, between the head office and permanent establishment, between two or more permanent establishments of the same entity or under a structured arrangement.

‘Mismatch outcome’ can be a:

1. ‘double deduction’ - deduction of the same payment, expenses or losses in the jurisdiction in which the payment has its source, the expenses are incurred or the losses are suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction). In the case of a payment by a hybrid entity or permanent establishment the payer jurisdiction is the jurisdiction where the hybrid entity or permanent establishment is established or situated;

2. ‘deduction without inclusion’ - deduction of a payment (or deemed payment between the head office and permanent establishment or between two or more permanent establishments) in any jurisdiction in which that payment or deemed payment is treated as made (payer jurisdiction) without a corresponding inclusion for tax purposes of that payment or deemed payment in the payee jurisdiction. The deduction is denied in the payer Member State. Where the deduction is not denied by the payer jurisdiction (e.g., because it has its source in a third country), the payment shall be included in the income of the payee Member State.

3. Double Tax Credit - To the extent that a hybrid transfer is designed to produce a relief for tax withheld at source on a payment derived from a transferred financial instrument to more than one of the parties involved, the Member State of the taxpayer shall limit the benefit of such relief in proportion to the net taxable income regarding such payment.

Types of hybrid

In addition to the amendment above, Article 9 of the amended Directive now details the following mismatch arrangements:

- Hybrid entity mismatches: Company treated as non-transparent in one country but transparent in the other;

- Hybrid financial instrument mismatches: tax treatment of a financial instrument differs between two countries;

- Hybrid Permanent Establishment (PE) mismatches: activities considered to be carried on by a PE in one country but not through a PE in another;

- Hybrid transfers: laws differ on whether the transferor or the transferee of a financial instrument has the ownership of the payments on the underlying asset.

- Imported mismatches: A Member State must disallow a deduction for any payment by a taxpayer to the extent that such payment directly or indirectly funds deductible expenditure giving rise to a hybrid mismatch through a transaction between associated enterprises or entered into as part of a structured arrangement. This rule should not apply to the extent that one of the jurisdictions involved in the transaction has made an equivalent adjustment in respect of such hybrid mismatch.

- Reverse hybrid mismatches: Member States in which such a reverse hybrid entity is incorporated or established and which regards the entity as a transparent entity, shall regard the entity as a resident of that Member State and tax the entity on its income to the extent that this income is not otherwise taxed under the laws of the Member State or any other jurisdiction.

- Dual resident mismatches: where the taxpayer is resident for tax in two countries - the taxpayer of the Member State will deny deduction to the extent that the other country allows the duplicate deduction to be set-off against income.

Member states will have until:

- 1 January 2020 to transpose the directive into national laws and regulations
- 1 January 2022 for Article 9a, concerning 'reverse hybrid mismatches'

www.consilium.europa.eu/en/press/press-releases/2017/05/29-corporate-tax-avoidance-hybrid-mismatches/

http://data.consilium.europa.eu/doc/document/ST-6661-2017-INIT/en/pdf

OECD peer review of BEPS Action 6 (treaty shopping)

Introduction

With all members of the Inclusive Framework on BEPS committing to implementing the minimum standards and participating in peer reviews, the aim is to achieve a timely and accurate implementation as well as making sure there is a level playing field for all members.

Each of the four BEPS minimum standards is subject to peer review:

1. Preventing treaty shopping (Action 6);
2. Country by country reporting (Action 13);
3. Fighting harmful tax practices (Action 5); and
4. Improving dispute resolution (Action 14).

Peer review – BEPS action 6

On 29 May 2017 the OECD released a document, approved by the Inclusive Framework on BEPS. This document forms the basis on which the peer review process will be undertaken for BEPS Action 6 minimum standard on preventing the granting of treaty benefits in inappropriate circumstances.

The document includes the criteria for assessing the implementation of the BEPS Action 6 minimum standard and the procedural mechanism by which the review will be conducted.

In order to comply with the minimum standard, tax treaties will need to include an:

- express statement that the common intention of the parties to the treaty is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements; and
- anti-abuse provision in the terms specified in Action 6 final report.

Conducting the peer review

Starting in 2018, the aim is to produce a first report on implementing the minimum standard by January 2019.

All members of the Inclusive Framework on BEPS will participate by:

- highlighting tax treaties that it has signed, separating those signed with other members of the Inclusive Framework on BEPS from those signed with non-members;
- indicating which of those treaties meet the minimum standard, the date of signature of the instrument that meets the minimum standard and whether the instrument has entered into force and effect.

The OECD's Working Party 1 (WP1) will:

- analyse the information provided by the BEPS members and look to reconcile divergent information that could be provided by the parties to the same treaty;
- review a consolidated version of the list at its September 2018 meeting to identify difficulties and discrepancies;
- finalise their revised consolidated version before the end of December 2018.

Difficulties agreeing

The peer review document also addresses the issue of countries facing difficulties in getting agreement from another country to amend an existing treaty in order to implement the minimum standard and includes the:

- process for resolution of interpretation and application issues that occur;
- process to be followed by members that encounter difficulties in getting agreement from another jurisdiction member of the BEPS framework; and
- confidentiality of documents produced in the context of the review process.

www.oecd.org/tax/beps/oecd-releases-peer-review-document-for-assessment-beps-action-6-minimum-standard.htm

Botswana, Djibouti, Thailand and Vietnam join BEPS

Botswana, Djibouti, Thailand and Vietnam have become the 97th, 98th, 99th and 100th jurisdiction to join the Inclusive Framework on BEPS.

The full list of members of the IF can be found at: www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

BEPS multilateral convention on tax treaties signed at OECD

On 7 June 2017 ministers and high-level officials from 76 countries and jurisdictions have signed today or formally expressed their intention to sign a multilateral convention that will implement a series of tax treaty measures to update the existing network of bilateral tax treaties and reduce opportunities for tax avoidance by multinational enterprises.

The OECD/G20 BEPS Project delivers solutions for governments to close the gaps in existing international rules that allow corporate profits to “disappear” or be artificially shifted to low or no tax environments, where companies have little or no economic activity. Revenue losses from BEPS are conservatively estimated at USD 100-240 billion annually, or the equivalent of 4-10% of global corporate income tax revenues. Almost 100 countries and jurisdictions are currently working in the Inclusive Framework on BEPS to implement BEPS measures in their domestic legislation and bilateral tax treaties. The sheer number of bilateral treaties makes updates to the treaty network on a bilateral basis burdensome and time-consuming.

The new multilateral convention will solve this problem. It will modify existing bilateral tax treaties to swiftly implement the tax treaty measures developed in the course of the OECD/G20 BEPS Project. Treaty measures that are included in the new multilateral convention include those on hybrid mismatch arrangements, treaty abuse, permanent establishment, and mutual agreement procedures, including an optional provision on mandatory binding arbitration, which has been taken up by 25 signatories.

The first modifications to bilateral tax treaties are expected to enter into effect in early 2018.

www.oecd.org/tax/ground-breaking-multilateral-beps-convention-will-close-tax-treaty-loopholes.htm

IASB issues interpretation on accounting for income taxes

On 7 June 2017, following a long period of consultation which started in October 2015, the International Accounting Standards Board (IASB) issued IFRIC 23 ‘Uncertainty over Income Tax Treatments’.

IAS 12 Income Taxes specifies how to account for current and deferred tax. However there will be occasions when it may be unclear how tax legislation applies to a transaction, or whether a taxation authority will accept a company’s tax treatment.

IFRIC 23 clarifies how the recognition and measurement requirements of IAS 12 are applied where there is uncertainty over income tax treatments

Where companies operate in a global tax environment, it is not always clear what tax treatments will be adopted. Adopting IFRIC 23 could prove challenging. It will be important to ensure that companies have appropriate processes and procedures in place to obtain the information that is needed to apply the requirements of IFRIC 23 and make the required disclosures.

Separately or collectively

A company must determine whether to consider each uncertain tax treatment separately or collectively based on whichever approach better predicts the outcome of the uncertainty.

An entity is required to use judgement to determine whether each tax treatment should be considered independently or whether some tax treatments should be considered together. The decision should be based on which approach provides better predictions of the resolution of the uncertainty.

An entity is required to use judgement to determine whether each tax treatment should be considered independently or whether some tax treatments should be considered together. The decision should be based on which approach provides better predictions of the resolution of the uncertainty.

Tax authorities' view

When considering whether and how an uncertain tax treatment affects taxable profits, tax bases, unused tax losses and tax credits as well as tax rates, a company must assume that a tax authority will have full knowledge of the facts and will examine everything that it has a right to examine.

Probability tax treatment(s) will be accepted

In determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, an entity must consider the probability that a taxation authority will accept an uncertain tax treatment.

Where the company believes that it is:

- probable that an uncertain tax treatment will be accepted, then their tax results should be determined and filed on that basis;

- not probable that an uncertain tax treatment will be accepted, then their tax results should be determined using whichever gives the better prediction of the likely outcome: the most likely amount or the expected value method.

Where fact or circumstances change, the company must reassess any judgements and estimates made based on the new information that is available.

Effective date

These new guidelines will be effective for periods beginning on or after 1 January 2019, with earlier adoption permitted.

VAT

MEPs report on MOSS extension

The EU Parliament's committee on economic and monetary affairs has published its draft report on the Commission's proposed changes to IT systems and administrative procedures for extension of the VAT mini one-stop-shop (MOSS).

The proposed new one-stop-shop (OSS) will cover services beyond the current scope of telecommunications, broadcasting and electronically supplied services and will include distance sales of goods.

This proposal and report involves amendments to the EU regulation on administrative cooperation and combating fraud in the field of VAT. It is a technical alignment of the regulation to accompany the main proposal for amendments to the principal VAT directive, on which the committee reported in May.

Both proposals are part of the Commission's wider package of proposed VAT directive changes on 'Modernising VAT for cross-border B2C e-commerce', issued in December 2016, aimed at improving operation of the VAT system in the context of the digital economy.

www.europarl.europa.eu/sides/getDoc.do?type=COMPARL&reference=PE-604.736&format=PDF&language=EN&secondRef=01

VAT repayment subject to corporation tax

Summary – The Upper Tribunal confirmed that a repayment of VAT is subject to corporation tax.

As the company's name suggests, Coin-a-Drink Limited supplies food and drinks to retail customers through vending machines.

Between 1973 and 1984, it accounted for VAT at the standard rate but it later realised that the supplies should have been treated as zero-rated. The company claimed repayment of the output tax for which it had incorrectly accounted for totalling £411,230.

HMRC agreed that the claim was justified and made the repayment in September 2009 paying statutory interest totalling to £949,452 as well.

Coin-a-Drink Limited included these payments in its profit and loss account for the period to 31 July 2010 but treated both amounts as non-taxable

HMRC opened an enquiry into the return and in January 2013 issued a closure notice amending the return by including both amounts within taxable profit.

Coin-a-Drink Limited appealed but the First tier Tribunal dismissed the appeal. The company accepted the decision that the interest was taxable but appealed to the Upper Tribunal regarding the VAT repayment.

Decision

In Shop Direct Group [2016] UKSC 7, the Supreme Court held that a repayment of output VAT was taxable profit in the year that it was received. Coin-A-Drink Limited argued that it was not a simple repayment within s 80, but represented the satisfaction of Coin-A-Drink Limited's free-standing European law right to restitution in accordance with the principles set out by the ECJ in San Giorgio (Case C-199/82) and applied in Littlewoods [2012] STC 1714. It followed that the state cannot make a payment of restitution, and then take part of it back by means of taxation.

Treating tax on profits as if it was a deduction from the repayment is incorrect. The Upper Tribunal concluded that the repayments were profits and so taxable. After all if no output VAT had been accounted for they would have been included within trading profits. There was nothing in San Giorgio or Littlewoods that supported the view that rules must be disapplied when a restitutionary payment leads to a trading.

Coin-A-Drink Limited v HMRC: [2017] UKUT 0211 (TCC)

Payment collection system

Summary- Post payment services provided a system of payment collection and so was standard rated.

PayPoint Network Limited are wholly owned subsidiaries of PayPoint plc, an international provider of payment solutions and other services.

PayPoint operated a payment scheme which enabled 'Customers' of utility companies, mobile telephone companies, and others 'Clients' to make credit top-ups, and to charge up pre-payment devices for electric or gas to be supplied by the clients ('pre-payment' transactions or services) and/or pay invoices or bills issued by the clients ('post-payment' transactions or services), over the counter at shops or other retail outlets (Agents).

The issue under appeal was whether post-payment services supplied by PayPoint Network Limited were standard rated or exempt under Item 1 of Group 5 of schedule 9 VATA 1994. This states:

> *Item 1 of Group 5 'Finance' of Schedule 9 states:*
>
> *The issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money.*

Decision

The Tribunal noted that although PayPoint Network Limited did provide its clients with a system through which payments were effected, and a network of agents to operate that system, it did not provide the service of receiving, collecting or transferring payments either functionally by netting off accounts or otherwise from customers.

PayPoint Network Limited's appeal was allowed.

Paypoint Network Limited V HMRC (TC05888)

Paying VAT that would cause hardship

Elbrook is a cash and carry wholesaler that also deals in alcohol wholesaling, operates a function hall, restaurant and a film studio.

HMRC denied Elbrook credit for input tax of £771,430.20 that had been deducted by Elbrook in computing its VAT for the five quarterly periods 01/2013 to 04/2014. Following a review, HMRC's decision and the assessment were upheld, and Elbrook filed a notice of appeal on 4 March 2015, in which it was stated that Elbrook had a pending hardship application before HMRC. From 24 March 2015, HMRC revoked Elbrook's authorisation under the Warehousekeepers and Owners of Warehoused Goods Regulations 1999 ("WOWGR").

On 28 April 2015, Elbrook's accountants sent a letter addressed to HMRC in support of Elbrook's hardship application but also stated that as a result of the cancellation of Elbrook's WOWGR authorisation:

- Payment of £750,000 had been made to a warehouse to enable the release of goods;
- Payment had been made in advance to certain suppliers who had demanded funds up front before despatching the ordered goods; and
- Certain professional fees had been paid to defend the cancellation of the WOWGR authorisation.

The letter also noted that there had been a drop in turnover and margins, and attached evidence to demonstrate that the company's bank deposit had reduced from £5 million to £300,000 by 2 April 2015 and that the company had used up its loan facilities of £5 million. The letter stated that there was immense pressure on the company's cash flow.

Elbrook had not approached its bank for further funds, as it had not wished to panic the bank but had approached American Express and other potential lenders.

On appeal, the First-tier Tribunal found in favour of the taxpayer, so HMRC appealed.

Decision

The Upper Tribunal noted that it could only interfere with the First Tier Tribunal's finding if it had made an error in law. The chance of finding a new source of finance should normally be ignored but if it was clear that finance was likely to become available, borrowing could be taken into account.

The Upper Tribunal agreed that the sale of fixed assets to raise new finance would cause hardship, that approaching its bankers was not an option and so concluded that the First Tier Tribunal had resolved fairly all the issues.

HMRC's appeal was dismissed.

CRC v Elbrook (Cash and Carry) Ltd, Upper Tribunal (Tax and Chancery Chamber), 10 May 2017

Discounts negotiated with breweries

Summary – Acting on behalf of publicans to obtain discounts from breweries to obtain a share of a discount was a VATable supply.

Redwood Birkhill Ltd acted on behalf of publicans negotiating discounts from breweries and retaining a portion of the discount. The balance was given to the publicans.

HMRC argued that Redwoord Birkhill Ltd provided a service of negotiating discounts with breweries by aggregating purchases. Publicans joined the company to benefit from the additional discounts. Clearly they were receiving a supply of services. Payment for the services was the share of the discount retained by the taxpayer. Therefore the discount kept by Redwoord Birkhill Ltd was liable to output tax for the services it had performed.

The taxpayer disagreed, saying the discount was not a supply, but a price adjustment.

Decision

First Tier Tribunal agreed with HMRC that Redwood Birkhill Ltd had supplied service to the publicans to achieve increased discounts. Redwood Birkhill Ltd had 'supplied' a discount and the consideration that was liable to output VAT was the retained sum

The Redwood Birkhill Ltd 's appeal was dismissed.

Redwood Birkhill Ltd v HMRC (TC5722)

Is equipment leasing a supply of goods?

Summary - Principal VAT Directive article 14(2)(b) applies only to leasing agreements which in the normal course of events, at the end of the agreement term, ownership of the leased asset is usually transferred to the lessee.

Mercedes-Benz Financial Services provides leasing (supply of services), hire purchase (supply of goods) and a mixed agreement called 'Agility' for the purchase and use of vehicles. The Agility product is recommended to customers who are undecided as to whether they want to own the car or want to keep open the option of whether to buy or not.

How do Agility agreements work? Following the expiry of the lease term, the lessee has the option to purchase the vehicle, subject to payment of the final amount. This amount corresponded to the average anticipated value of the vehicle at the time of purchase.

How should they be treated for VAT?

- Mercedes-Benz believed that Agility agreements are a lease rental agreement with an option to purchase at the end. They should be treated as services and VAT payable on the instalments when paid.

- HMRC argued that because there is the possibility that title to the goods would pass, there is a supply of goods with VAT payable upfront.

The Advocate General (AG) said that article 14(2) (b) covers leasing agreements and contains a clause that in the normal course of events ownership is to pass at the latest upon payment of the final instalment. Such an agreement must therefore contain an ownership transfer clause, which can be either a decision automatically to transfer ownership by the end of the agreement term or an option to purchase the leased asset; and transfer of ownership must follow from the normal course of events and must take place at the latest when the final instalment is paid.

The AG concluded that:

> 'A lease is often a substitute for ownership of an asset, although it is not necessarily, unlike hire purchase agreements, a means by which to acquire ownership … I do not believe that contractual freedom should be restricted (with the obvious exception of fraud and abuse) by treating as a supply of goods, without any clear justification, a legal relationship which the parties have deliberately structured as a supply of services.'

The AG has agreed with that taxpayer that Agility arrangements are supplies of services meaning that VAT is accounted for when instalments are paid rather than upfront.

HMRC v Mercedes-Benz Financial Services UK (Case C-164/16)

Tax Journal (16 June 2017)

Contract bridge – is it a sport?

Summary - The Advocate General considered that contract bridge is a sport.

The English Bridge Union organises bridge tournaments, charging participants an entry fee to play that had been subject to VAT. However, the English Bridge Union made a claim for repayment of VAT on the grounds that these entry fees should be exempt as they are services linked to sport (Principal VAT Directive article 132(1)(m)).

Is contract bridge a sport?

Decision

The AG concluded that sportincludes 'the training of mental or physical fitness in a way that is generally beneficial to the health and the well-being of citizens' and that 'The definition necessarily excludes games of chance, as there is no relation between the effort invested and the outcome, and the tasks involved do not require any mental or physical skill.'

The AG highlighted that the International Olympic Committee includes chess among the activities that have Olympic status. The AG inferred from this that physical effort is not a requirement. The AG concluded that contract bridge is a sport.

The English Bridge Union v HMRC (Case C-90/16)

Paying over the odds!

Summary – The Upper Tribunal found that excess amounts paid by customers at pay and display car parks were consideration for VAT.

National Car Parks Limited, NCP', operates 'pay and display' car parks. Persons parking must display a ticket in the car showing that it is allowed to be in the car park for a specified time. The ticket is obtained from a machine. Different amounts are payable for tickets at different times and depending on how long the car is to be parked. The amounts payable are set out on a tariff board or boards in the car park. This appeal concerns machines that accept payment in cash. Where customers do not have the correct change to pay the exact amount stated on the tariff board, they must, if they wish to park, put in more than the amount due as the ticket machines do not give change.

In October 2014, NCP made a claim for repayment of overpaid VAT of £488,669 in respect of overpayments of car park tariffs by customers but HMRC refused the claim, claiming that the overpayments represented consideration for the right to park.

Decision

Following Dutch Potato (Case C-154/80) and Campsa (Case C-285/10) consideration for VAT is 'the value actually given by the customer …. in return for the service supplied and actually received by the supplier and not a value assessed according to objective criteria'. The tribunal held that what was shown on the machine or written on the ticket was of limited relevance.

A customer is given the right to park their car for one hour in return for inserting not less than £1.40. Where a customer pays £1.50, that amount is the value given by the customer and received by the supplier in return for the right to park for up to one hour.

National Car Parks Limited v HMRC (National Car Parks v HMRC [2017] UKUT 247)

Planning in the current market (Lectures B1023/B1024 – 9.21/7.47 minutes)

Building new dwellings

Construction costs

Construction services incurred when building a new dwelling are generally zero rated. White collar workers are excluded from these provisions and must charge VAT at the standard rate e.g. architects, surveyors etc.

Building materials bought in isolation will be standard rated. Building materials supplied with construction services will be zero rated.

So if a main contractor bought building materials from a builders yard VAT at the standard rate would apply to his purchase.

If a carpenter bought timber from the timber yard VAT at the standard rate would apply. If the carpenter charged the main contractor for carpentry services (including the timber) then the carpenter's invoice to the main contractor would be zero rated.

Onward supply

The sale of a newly constructed dwelling will be zero rated.

VAT will therefore be recoverable on any costs incurred such as building materials bought in isolation, architects fees etc.

Zero rating will also apply to the lease premium of a lease over 21 years – hence allowing input recovery on the construction.

Planning

Developments should always be undertaken in a corporate. If the developer ends up letting some of the completed stock you then have the option of selling the letting stock to a letting subsidiary free of SDLT.

You would need to evaluate the VAT saving and compare this to the corporation tax liability on the profit when selling to the subsidiary company. It should however be noted that the corporation tax charge is just a timing difference whereas VAT is a true cost. The overall business will have to pay corporation tax on the profit at some point!

Building relevant residential or relevant charitable buildings

Construction costs

Construction services incurred when building a new relevant residential or relevant charitable property are zero rated when provided to the user of the property. You have to be invoicing the user of the property to secure zero rating as it is only they that can give the supplier a certificate that the building will be used for relevant residential or relevant charitable purposes.

The definition of relevant residential is found within VATA 1994 Schedule 8 Group 5 Note 4 and will include care homes, children's homes and residential accommodation for students.

The definition of relevant charitable is found within VATA 1994 Schedule 8 Group 5 Note 6. The key is that the property is going to be used otherwise than in the course or furtherance of a business. HMRC accept that 95% non-business use would meet this criteria – see HMRC Brief 32/10. Charitable use also includes use as a village hall but this is less common.

In view of the fact that you need to receive a certificate from the user to zero rate construction services for relevant residential and relevant charitable, zero-rating would not apply to services provided to the main contractor – by sub-contractors for example. The main contractor cannot issue a certificate so any services it buys in will be standard rated.

The main contractor will have a certificate from their client so zero rating will apply when billing the client for construction services – thus allowing input tax on sub-contracted costs incurred by the main contractor to be recovered.

Consider a rest home operator that purchases a plot of land with a view to constructing another rest home. They place the build contract with ABC builders who quote a zero rated price on the basis that their client will certify that the property will be used for relevant residential purposes.

When ABC Builders out-source some of the construction work they will expect to be charged the standard rate as they cannot certify the use of the property – only the user can.

Onward supply

The sale of a newly constructed relevant residential or relevant charitable property will be zero rated providing the buyer certifies the usage. This scenario is less likely than the ABC Builders example above. The key is whether you are providing construction services (per ABC Builders) or selling the property itself.

Planning

Design and build contracts would be common in this area. Traders like ABC Builders are asked to enter into "design and build" contracts so they can pass the architects fee onto the client as part of the zero rated construction contract. The architect contracts with ABC Builders and charges them the standard rate. This will be recovered by ABC Builders as it relates to their zero rated build contract with the rest home operator.

Converting commercial properties to dwellings or relevant residential

Purchase of commercial property

The purchase of a commercial property will be exempt. If an option to tax is in force the buyer will need to provide a certificate (Form 1614D) to the seller (on or before exchange) to secure exemption. The certificate should confirm the extent of dwelling or relevant residential use going forward e.g. two floors out of three. The option is only disapplied to the extent of the dwelling or relevant residential use e.g. two thirds.

If a developer is buying to convert to relevant residential use they would need a Form 1614D from their intended buyer to enable to developer to provide their own Form 1614D to the current seller.

Disapplying the option to tax will be useful to reduce the SDLT charge and to improve cash flow. It does also reduce the risk of irrecoverable VAT should the buyer not make any onward taxable supplies with the converted property. This would be especially so when dealing with relevant residential buyers e.g. converting a hotel into a rest home.

Conversion work

VAT should be charged at the reduced rate of 5% on qualifying services supplied in the course of certain residential conversions. Generally the lower rate will apply to commercial property being converted to flats.

The 5% rate will also apply when converting to relevant residential IF the services are supplied to the user of the property. If you are a developer converting a property into relevant residential use then the 20% rate will apply.

Building materials and certain electrical goods, supplied by the person providing the above services and incorporated into the building in question or its immediate site, are also subject to the reduced rate.

Building materials supplied in isolation will be standard rated.

Onward supply (or own use)

The zero-rating legislation covers the first grant of a major interest by a person converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or number of dwellings or intended for use solely for a relevant residential purpose. This might be where someone is converting a warehouse building into flats or a barn into a house.

If the major interest grant is not present then the onward supply will be exempt e.g. 12 month rental tenancies.

Providing an onward zero rated supply is made the VAT incurred on the conversion work is recoverable. If the converted property is to be sold for relevant residential use then the developer would need to obtain a certificate from the buyer to secure zero rating of the onward supply. This is a different certificate to the 1614D they may have previously obtained from the buyer to secure exemption on the purchase of the commercial property. The developer would have incurred 20% conversion costs so the onward zero rating would be critical.

Planning

A relevant residential operators is contemplating buying a commercial property themselves and engaging a contractor to convert it. The VAT rate on the conversion is 5%.

Would it be any better if they set up their own development company to buy and convert the property? When converted it could be sold to the rest home operator at the zero rate hence making the project VAT free. There would be no SDLT on the property sale as the development company would be in a 75% group with the rest home operator. This structure works well from a VAT perspective BUT you will need to consider the corporation tax charge when the development company sells to the rest home operator. There will be a market value appropriation from stock to fixed assets and then a no gain, no loss transfer to the rest home operator. There are no reliefs for the market value appropriation and there will be a corporation tax charge on any development profits.

<u>Converting houses to flats</u>

Purchase of the house

The purchase of a house will be not be subject to VAT.

Conversion work

VAT should be charged at the reduced rate of 5% on qualifying services supplied in the course of certain residential conversions. Generally the lower rate will apply to houses being converted to flats as the number of dwellings is changing.

Building materials and certain electrical goods, supplied by the person providing the above services and incorporated into the building in question or its immediate site, are also subject to the reduced rate.

Building materials supplied in isolation will be standard rated.

Onward supply

The onward sale (or rental income) will be exempt.

If the house has however been empty for 10 years or more the sale can fall within the zero rated provisions as a qualifying conversion.

Input tax will not be recoverable if the onward supply is exempt.

Planning

Developers who regularly convert houses into flats should have a separate services company so as to avoid any 20% VAT on building materials. The services company will pay VAT at 20% on their building materials but will then charge their "parent" company 5% VAT on the conversion contract. The 20% VAT is recovered which minimizes the project VAT cost to just 5%.

Business splitting……pitfalls to avoid (Lecture B1025 – 13.44 minutes)

Introduction

A business splitting arrangement takes place when two businesses trade independently eg as two sole traders, instead of, say, a single partnership. The end result is that both entities will get a registration threshold of £85,000 before they need to register.

Husband sole trader is an architect earning £60,000 each year. Wife sole trader is a surveyor earning £50,000 each year. If HMRC issued a direction that they were a single partnership business, with annual turnover of £110,000, they would need to register for VAT and account for output tax on their sales.

Graham and Christine Belcher case (TC5891)

This was an incredible case because the tribunal ruled in favour of the taxpayer, despite the fact that many factors indicated they were trading as a partnership hairdressing business rather than two sole traders.

And because the arrangement had not been split properly in the past, according to HMRC, the officer went back 10 years with a late registration (they can go back up to twenty years to correct a late registration).

Case background

Here are the important facts of the Belcher case:

Mr Belcher traded as a barber shop from 1991 and his wife as a ladies hairdresser part time from 1997 to 2005 from the same premises and then full-time when she quit her job with the DSS in 2005.

They traded under the name of "Crewe Cuts" (the town where the business was based) and completed partnership tax returns for self-assessment purposes. Their accountant produced only one set of annual accounts for the partnership and they had only one account with key suppliers.

They also had joint insurance policies and a joint music license for the premises and shared the same telephone line. There was only one business bank account combining both activities.

HMRC began enquiries in 2015 and registered the partnership for VAT from 1 January 2006, based on turnover figures declared on the partnership returns. The net VAT owed was £136,691 plus a late registration penalty of £15,829.

Note – this is an important fact about VAT registration, namely that HMRC has the power to go back up to twenty years and collect arrears of tax. It is only the correction of errors made on past VAT returns where a four-year time cap applies.

Partnership tax return

Based on the above facts, you can probably see why I wrongly concluded that the Belchers had no chance of convincing the court that they traded as independent sole traders, with each business trading below the VAT registration threshold. After all, it was by choice that they had completed a 'partnership self-assessment tax return' and they were obviously fully aware that their accountant completed only one set of accounts and they had a single business bank account.

Here is the statement at the bottom of the partnership tax return:

> "I, the nominated partner, declare that the information I have given on the Partnership Tax Return is correct to the best of my knowledge and belief". This statement is signed by the "Nominated Partner"

The word 'partner' or 'partnership' appears three times in the above statement and as you would expect, the return is also headed in bold and enlarged print: Partnership Tax Return.

Factors that indicate separate businesses

So how did the Belchers convince the FTT that they were actually trading as two sole traders, despite the weight of evidence stacked against them? The judge found the following facts:

- The businesses paid for cash expenses separately from their respective tills;
- Staff hiring and firing was done independently;

A key point was that the tribunal concluded that there had been "no conscious intention to run a single business in partnership." (para 66). The judge also noted that Mrs Belcher had said that if either part of the business was sold, this would be the sole decision of the owner of that particular trading business and not a joint partnership decision.

The judge was also "very impressed" that Mrs Belcher had told the HMRC officer as soon as he started his enquiry that there were two separate businesses: "That was Mr and Mrs Belcher's case from the beginning and it has not changed." (para 67). He also noted that HMRC had not asked the Belchers about their trading intentions, as suggested in policy note VATDSAG03200 of the manual *Single Entity and Disaggregation*. The appeal was allowed.

The legislation

So what does the law say about this issue, which is sometimes described as 'artificial separation' – see *Business splitting legislation*.

The key point is that HMRC needs to prove that the two businesses have 'financial, organisational and economic links' and the important word is 'and' ie HMRC need to prove all three links – one or two out of three is not good enough. In such cases, they have the power to issue a direction to treat the separated businesses as a single partnership, and register them for VAT moving forward if the combined turnover exceeds the registration threshold.

However, as long as the separation has been done correctly, they do not have power to retrospectively collect tax. This was the key point in the Belcher case, namely that the officer considered that the separation had not been done properly. There were no separate bank accounts, trading names, annual accounts, supplier accounts etc, so he treated the arrangement as a late registration going back 10 years.

So what do these three links mean in practice? There used to be guidance in HMRC Notice 700/1 (Registration) but this seems to have been taken out of recent editions, so I have shown an extract from a Statement of Practice issued on 1 April 1983, which still seems to be relevant – see *Business links*.

Business splitting legislation – VATA1994, Sch 1:

> 1A(1) Paragraph 2 below is for the purpose of preventing the maintenance or creation of any artificial separation of business activities carried on by two or more persons from resulting in
>
> (2) In determining for the purposes of subparagraph 1A above whether any separation of business activities is artificial, regard shall be had to the extent to which the different persons carrying on those activities are closely bound to one another by financial, economic and organisational links.

Business links…..extract from HMRC Statement of Practice issued on 1 April 1983:

Financial links:

- Financial support given by one part to another part
- One part would not be financially viable without support from another part
- Common financial interest in the proceeds of the business

Economic links

- Seeking to realise the same economic objective
- The activities of one part benefit the other part
- Supplying the same circle of customers

Organisational links

- Common management
- Common employees
- Common premises
- Common equipment

Conclusion

A bit of advanced thinking and proper planning, and the Belchers would have avoided a retrospective problem. The case illustrates that separate entities need to take all factors into account to create independent businesses, and commercial reality must clearly indicate that separate entities are in place. This is particularly important when family members are involved because there is less incentive to conduct proceedings on an arms-length basis.

Contributed by Neil Warren